

CHAPTER 11

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CHAPTER 11

11-000 Audit Of Contractor Compliance With Contract Financial Management Requirements**11-001 Scope of Chapter**

This chapter provides guidance that is peculiar or special to the accomplishment of the audit of contractor compliance with contract financial management require-

ments. To the extent appropriate under the circumstances, Chapters 3, 4, 5, and 6 of this manual are equally applicable to the audit assignments discussed in this chapter.

11-100 Section 1 --- Audit of Contractor Compliance with "Limitation of Cost," "Limitation of Funds," and "Limitation on Payments" Clauses**11-101 Introduction**

This section provides guidance for auditing contractual limitations on costs, funds, and payments.

11-102 General

Contract limitation of cost clauses (FAR 52.232-20 and 21) and limitation of funds clause (FAR 52.232-22) contain financial reporting requirements for cost-type contracts. The contract limitation on payments clauses (FAR 52.216-5, 6, 16, and 17) contain financial reporting requirements for contracts with price redetermination provisions and fixed-price incentive contracts. The limitation of cost and funds clauses in cost-type contracts require the contractor to advise the contracting officer in writing whenever the contractor has reason to believe that costs expected to be incurred under the contract in the next 60 days (may vary between 30 and 90 days) when added to all costs previously incurred, will exceed 75 percent (may vary between 75 and 85 percent) of the estimated total contract costs or funds allotted to the contract, respectively. The limitation of cost clause also requires the contractor to notify the contracting officer when there are indications that the total cost for the performance of a contract will be substantially greater or less than the estimated total contract cost. Under FAR 52.232-20, 52.232-21, and 52.232-22, the Government is not obligated to reimburse the contractor for costs incurred in excess of cost or funding limitations. Simi-

larly, the contractor is not obligated to continue performance under the contract or otherwise incur costs in excess of the limitation or, if the contract is cost sharing, the amount then allotted by the Government to the contract plus the contractor's corresponding share. However, if the Government notifies the contractor in writing that the amount allotted to the contract has been increased and specifies the amount, the Government is then obligated to the total revised amount allotted to the contract. The limitation on payments clause in contracts with price redetermination provisions and fixed-price incentive contracts requires the contractor to report to the contracting officer the costs in relation to billing prices on items for which final prices have not been established. The objective of Limitation on Payments Statement quarterly submissions is to keep billing rates during contract performance in line with expected final prices; indicated overpayments can be recouped and excessive billing rates adjusted on a timely basis. This is a minimum requirement. The contract or the procuring agency may require additional reporting, or the contractor may prepare other internal reports in addition to those required by the Government.

11-103 Scope of Audit

Knowing the management tools available to a contractor in controlling, projecting and monitoring contract costs is of utmost importance. Obtaining this knowledge is an integral part of system audits aimed at determining the adequacy

of contractor financial management systems. It is important for the auditor to ascertain that the contractor has the financial management tools necessary to adequately identify potential contract overruns or underruns. The auditor should promptly notify the contractor and the ACO of any deficiencies. In evaluating the contractor's financial management policies and procedures, the auditor should ascertain:

a. The nature and adequacy of controls which govern the establishment of budgets; the procedures for accumulating incurred costs by budget element; the actual cost compared to budgeted costs; the means provided for comparing incurred costs to the percentage of contract completion; and development of estimates to complete (ETC).

b. Whether the contractor's organization effectively utilizes its financial management tools to promptly report potential cost overruns and underruns to contractor management and subsequently to the Government.

c. The methods by which the overall contract financial controls relate to the day-to-day supervisory controls maintained at the operational level.

11-104 Audit Procedures

The audit procedures suggested in this section are not intended to be all-inclusive; the auditor, after considering these guidelines, must develop an audit program based on individual circumstances. At the beginning of the audit the auditor should coordinate with the cognizant contracting officer as discussed in 4-103.

11-104.1 Determination of Reporting Requirements

When appropriate, the auditor should:

a. Determine, from contract briefing files or other available sources, those contracts which require limitation of cost reports, limitation of funds reports, or limitation on payments statements.

b. Ascertain whether the contractor is required to meet additional reporting requirements not specifically required by the contract.

c. Ascertain whether internal reports, in addition to those required by the contract, are prepared to increase internal financial

management controls. If so, they should be compared with the reports submitted under the contract to determine whether significant differences exist.

d. Compare the reporting requirements among various contracts and determine whether there is duplication in the reports required and in the information assembled. The auditor should consider the possibility of the contractor using reports required by one military department, command, or Service to satisfy the needs of all contracting officers.

11-104.2 Evaluation of Reporting Controls

When appropriate, the auditor should:

a. Evaluate the contractor's procedures applicable to the budgetary controls of individual contracts and compare the estimated cost of individual tasks and departments in the cost estimate with the budgeted funds.

b. Ascertain and evaluate for each division (or plant) the internal procedures for controlling the financial status of Government contracts and determine the source of the reported incurred costs and the basis for ETC. The auditor also should determine the extent and frequency of supervisory reviews of the status reports and whether explanations are required when there are significant deviations from the budget.

c. Ascertain and evaluate the manner in which revised ETC, in terms of engineering and production manhours, relate to the production control schedules and engineering manpower schedules at specific work centers.

d. Evaluate the documentation flow of the financial status reports from the various sources to the finance manager responsible for preparing the overall financial report for the assigned project.

e. Evaluate the controls exercised by the finance manager, including:

(1) the manner in which the source data are reviewed for reliability,

(2) the basis for changes to the source data, and

(3) a determination of the extent to which requests for explanations from operations responsible for the source data are

made relative to causes of potential cost overruns or underruns.

11-104.3 Audit Objectives

The audit objectives are:

(1) to determine whether the contractor has complied with the reporting requirements contained in the contract clause and

(2) whether the financial data contained in the contractor's reports and statements are reasonable and consistent with the data presented in other required Government reports and/or claims.

11-104.4 Audit Guidelines

The audit guidelines which are applicable to the minimum reporting requirements in 11-102 are as follows:

a. Ascertain whether the contractor is submitting reports required by its contracts. Compare these reports with the contractor's internal financial reports for consistency.

b. Evaluate limitation of cost reports. The limitation of cost clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of, or will be greater or substantially less than, the estimated cost specified in the contract. The contractor must submit a revised estimate of the total cost of performing the contract as part of the notification. Limitation of cost reports should be evaluated using the following guidance:

(1) Evaluate the contractor's revised EAC using the guidance in 14-205f.

(2) Ascertain whether the limitation of cost reports in successive periods reflect significant cost underruns or overruns.

(3) Ascertain whether the contracting officer has obtained contractor explanations for overruns when continuous overruns have occurred over an extended period.

(4) When continuous underruns are projected over an extended period, and when the overall estimated contract price has not been reduced, the auditor should ask the contracting officer why.

(5) When individual contracts indicate continuous significant cost overruns or underruns, the auditor should evaluate this condition in relation to the price established at the time of award. If it is determined that consistent overruns or underruns resulted from defective initial pricing, the contracting officer should be so advised.

c. Evaluate limitation of funds reports. The limitation of funds clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of the funds currently allotted or, for cost sharing contracts, this amount plus the contractor's corresponding share. This notice must include an estimate of the amount of additional funds required to continue performance for the period specified in the contract. Limitation of funds reports should be evaluated using the guidance in 11-104.4b above.

d. Evaluate limitation on payments statements. Limitation on payments (LOP) statements must be submitted quarterly, in accordance with the provisions of FAR 52.216-5, 6, 16, or 17. The primary objectives of LOP statements are to provide for recoupment of overpayments and to indicate a need for a reduction in billing prices. These conditions become apparent when the contractor is underrunning targets used to establish billing prices. Overruns are indicated when estimated final prices exceed invoice amounts. This indicates possible need for increased billing prices and/or revision of liquidation rates. The general objective is to keep billing prices in line with expected final prices during contract performance. Progress payments and LOP statements should be evaluated at the same time. Even though a request for audit may specify a particular document, auditors should try to identify both submissions with comparable cutoff dates for direct comparison and reconciliation. Evaluate LOP statements and reconcile them to progress payment requests using the following guidance:

(1) The auditor should determine that costs related to delivered items are the same as the amounts excluded from costs shown as a basis for unliquidated progress pay-

ments (Item 20a of the progress payment request).

(2) The price of items invoiced should be the same as Item 21a on the progress payment request when both submissions have the same cutoff date.

(3) The EACs used to prepare LOP statements and progress payment requests should be the same. The most current estimates should always be used. EACs should be evaluated using the guidance in CAM 14-205f.

(4) The auditor should assure the comparability of contract items used in computations required by the various subsections of the Limitation of Payments Statement. In all instances, cost data should relate to supplies and services delivered and accepted.

(5) The auditor should determine the methods used by the contractor to identify actual costs of delivered and invoiced items. Understatement of this amount usually results in an overpayment of progress payments by overstating the costs eligible for progress payments applicable to undelivered and uninvoiced items.

(6) The auditor should ascertain whether the contractor makes prompt refunds or adjustments when cost underruns are indicated in the performance of fixed-price redeterminable contracts.

11-104.5 CAS Compliance

The auditor should determine if reporting practices comply with CAS 401, "Consistency in Estimating, Accumulating, and Reporting" (See Chapter 8).

11-105 Reports

Reports will be furnished in response to specific requests for evaluations in this area. Audit reports will be prepared in accordance with 10-1200. When there is reason to recommend correction of a substantial deficiency, a special report will promptly be initiated by the auditor even if there is no request from a contracting officer. Other deficiencies may be included in periodic reports on the overall system of accounting and internal control.

11-200 Section 2 --- Audit of Contractor Compliance with Earned Value Management System (EVMS) Guidelines

11-201 Introduction

a. This section provides guidance for auditing contractor management systems on selected contracts. The mandatory guidelines that must be met by the contractor are prescribed in DoDI 5000.2.

b. In December 1996, the Under Secretary of Defense (Acquisition, Technology and Logistics) accepted Industry Guidelines for Earned Value Management (EVM) replacing the DoD Cost/Schedule Control System Criteria (C/SCSC). The industry guidelines adopted by DoD are the American National Standards Institute (ANSI)/Electronic Industries Alliance (EIA) EVMS standard (ANSI/EIA-748-1998). The implementation of EVMS guidelines for DoD contracts is contained at DFARS 234.005-70, 252.234-7000 and 252.234-7001. The Interim Defense Acquisition Guidebook (formerly DoD 5000.2-R), Subpart C2.9.3.4, Integrated Contract Performance Management, and Appendix IV, Earned Value Management System Guidelines, were revised to reflect the mandatory EVMS guidelines for a contractor's management system to effectively manage selected weapons systems contracts. The guidelines represent the framework for an integrated management system that provides for:

(1) planning the timely performance of work,

(2) budgeting resources,

(3) accounting for costs and measuring actual performance against plans, and

(4) replanning resources needed to complete the contract when significant deviations from plans are identified.

A contractor's management system must meet 32 guidelines organized into the following five major categories: Organization; Planning, Scheduling and Budgeting; Accounting Considerations; Analysis and Management Reports; and Revisions and Data Maintenance. Detailed uniform guidance for implementing the guidelines and conducting systems audits is provided

in the Earned Value Management Implementation Guide (EVMIG) (reference DCAA Pamphlet (DCAAP) 7641.47). The EVMIG may be accessed through the DCAA Intranet under DCAA Audit and Administrative Guidance. The Interim Defense Acquisition Guidebook may be found on the DoD 5000 Series Resource Center website (<http://dod5000.dau.mil/>).

c. DoDI 5000.2 requires the implementation of EVM guidelines on contracts or agreements for research, development, test and evaluation (RDT&E) with a value of \$73 million or more; and procurement or operations and maintenance (O&M) contracts or agreements with a value of \$315 million or more (in fiscal year 2000 constant dollars). Exceptions may be made for individual contracts. In any event, the auditor must refer to the specific terms of the contract to determine whether the contract contains reporting requirements for EVMS guidelines. General responsibilities of the auditor during EVMS implementation and surveillance are delineated in the Earned Value Management Implementation Guide (EVMIG), which supplements and elaborates on the provisions of DoDI 5000.2.

d. The Defense Contract Management Agency (DCMA) is the DoD Executive Agent responsible for the implementation of EVMS on DoD contracts. DoD components are required to implement earned value effectively and notify DCMA of their EVMS focal point.

e. Since DoD's C/SCSC are considered to be equivalent to EVMS guidelines, contractors' previously approved cost/schedule control systems are considered to be acceptable under the EVMS guidelines. Accordingly, contractors with acceptable cost/schedule control systems under C/SCSC are not required to demonstrate that their management systems meet the EVMS guidelines, and are not subject to the initial compliance audit procedures outlined in 11-202.2.

11-202 EVM Integrated Baseline Reviews, Initial Compliance Audits, and Post Acceptance Audits for Cause**11-202.1 Integrated Baseline Reviews**

The Integrated Baseline Review (IBR) is a joint assessment conducted by the Government and the contractor following contract award to verify the technical content of the Performance Measurement Baseline (PMB) and the accuracy of the related resources (budgets) and schedules. The IBR will be conducted within six months of contract award. An IBR will also be conducted when work on a production option of a development contract begins or, at the discretion of the program manager, when a major modification to an existing contract significantly changes the existing PMB. The IBR is a streamlined approach to assessing the PMB on new contracts. The IBR is conducted under the assumption that the contractor is using an accepted EVMS internally for program management, and that there is a thorough and effective Government surveillance program ongoing at the contractor's facility. Therefore, this audit is not as comprehensive as the initial compliance and post-acceptance audits of contractors' EVMSs. Accordingly, audit assistance will not usually be requested. However, when any part of the system is not clearly understood, the assistance of the auditor may be desired. If the assistance of the auditor is needed, the program manager will notify the cognizant auditor as soon as possible. The auditor will be responsive to the program manager for evaluation of those accounting and/or financial aspects of the contractor's system.

11-202.2 Initial Compliance Audits

a. DFARS 252.234-7001, Earned Value Management System, requires the contractor to be prepared to demonstrate that its management system complies with the EVMS guidelines as required by DoDI 5000.2. Contractors whose EVMS was accepted for application to another contract of the same type (e.g., development or production) at the same facility will not be required to undergo an initial compliance audit. The initial compliance audit is con-

ducted by a DoD team whose leader is appointed by DCMA. The team includes a DCAA auditor. Team members should be advised in advance of the estimated audit start date and furnished information about the contractor's EVMS.

b. The team will make a Progress Assistance Visit (PAV) to the contractor's facility, normally within 30 days after contract award, to conduct an initial audit of the EVMS description. The contractor will usually make presentations on the EVMS's design and operation and explain applicable reports. The team will examine selected documents and procedures proposed by the contractor, and a schedule will be developed for future visits to conduct the IBR and the initial compliance audit. Areas of noncompliance and potential problems will be identified. Recommendations for systems improvements should be forwarded to the team leader for evaluation and discussion with the contractor. The contractor will be given an opportunity to correct noted deficiencies.

c. The EVMS initial audit should begin as soon as practicable following completion of the PAV and implementation of the EVMS. The contractor will demonstrate to the team how the EVMS is structured and used in actual operation. The contractor shall provide the team with a written description of the EVMS. The review team will examine contractor records and information to ascertain compliance with the EVMS guidelines and document its findings.

d. After the demonstration review, the team will conduct the initial compliance audit using the system characteristics contained in the EVMS Evaluation Guide (Appendix B of the EVMIG). During the initial compliance audit, the contractor will provide an overview briefing to familiarize the team with the proposed EVMS and identify any changes to the EVMS since the most recent PAV. If necessary, the team will evaluate any changes to the PMB since the most recent IBR. The team will evaluate, on a sampling basis, the reporting of cost and schedule performance against the baseline plan to verify the adequacy of contractor controls and accuracy of management reporting information. The team may conduct interviews of selected con-

tractor personnel to verify that the EVMS is fully implemented and being used in the management of the contract. A report will be issued 30 days after completion of the audit and approval of all significant contractor corrective actions, if necessary.

e. A system for controlling development effort is generally different from a system for controlling production work; accordingly, separate initial compliance audits may be required for each, although only one program may be involved. Simultaneous audits of the EVMS used for development and production may be performed. This eliminates the necessity for multiple audits. In addition, the contractor may implement one system for both types (development and production) of contracts. When the contractor implements one system for both types of contracts, the system to gain acceptance must clearly demonstrate that it meets the guidelines applicable to production type contracts in the way work is planned and controlled and the way costs are collected and analyzed. The focus of the compliance audit will be determined by the extent and nature of the production effort in the contract.

f. After the successful completion of an initial compliance audit, an advance agreement between the Government and the contractor is executed, which specifies that the contractor will maintain and use the accepted EVMS as an integral management process on the current, as well as future, contracts. The agreement should be incorporated into each contract requiring the application of the EVMS guidelines. The agreement is signed by the ACO and a contractor representative at the commensurate level, e.g., the division manager may sign the agreement when the EVMS is used throughout the corporation's division. In addition, a Memorandum of Agreement (MOA) may be executed between the Program Management Office (PMO) and the Contract Management Office (CMO). The MOA identifies key Government EVMS individuals and establishes the working relationships between the PMO and CMO. Auditors normally should not be requested to sign advance agreements or MOAs. The auditing standard of independence precludes DCAA from entering into most agreements. Auditors may communicate in

writing by a memorandum to the CMO the auditor's expected role in the EVMS surveillance process. If the CMO insists on the FAO entering into an advance agreement or MOA, the FAO should send the proposed agreement or MOA and background material through the regional office to Headquarters, ATTN: P, for coordination before executing the agreement or MOA.

11-202.3 Post Acceptance Audits for Cause

After the initial acceptance of a contractor's EVMS, no further audits for system acceptance will be conducted unless there is a specific need determined by the Government. A post acceptance audit may occur when conditions warrant, e.g., solving a major system application problem identified by the program manager or a surveillance monitor. The scope and conduct of the audit will focus on the system processes affected by the problem. The audit will be scheduled based on written Government notification to the contractor. The review team director will be selected by the CMO EVMS monitor and the review team will be composed of the appropriate EVMS Government surveillance personnel needed to address the identified problem. The review is similar to an initial compliance audit, and the EVMS Evaluation Guide should be used when compliance with specific guidelines is required. The review director will issue a report within 30 days after completion and approval of all significant contractor corrective actions.

11-202.4 Auditor Participation in Integrated Baseline Reviews, Initial Compliance Audits, and Post Acceptance Audits for Cause

Upon receipt of a specific request, the FAO will assign an auditor to be a member of the IBR, initial compliance audit, or post acceptance audit for cause team. Auditors assigned to these teams should be familiar with the EVMIG and have some training in EVMS guidelines. Prior to the audit, auditors should become thoroughly familiar with the contractor's EVMS by reviewing the contractor's system description and

analyzing cost management reports for the contract under audit, if applicable.

11-202.5 Audit Objectives

The auditor's primary objective is to audit the accounting system and related financial areas to determine whether the management control system complies with the EVMS guidelines on areas assigned and is being implemented on the contract under audit. The auditor is responsible for advising the team chief, on the areas audited, of the conclusions and will be responsible to the team chief for the timely completion of the effort specifically assigned. As members of an EVMS guidelines review team, auditors may be involved in cost account/functional manager interviews, questionnaire completion, discrepancy report preparation, documentation audits, and audit report preparation. Auditors should perform as much preliminary work as possible in advance of the team visit in order to provide conclusions on any EVMS deficiencies to the team chief by the end of the EVMS guidelines audit.

11-202.6 Scope of Audit

a. The DCAA team member is responsible for the preparation and execution of a detailed audit program for all areas assigned by the team chief. Technical direction will be provided by an audit supervisor. Auditors should also assess whether deficiencies disclosed in reports on MMAS, labor, other accounting systems, forward pricing rates, budgets, and billing systems are likely to affect the contractor's EVMS. If the contractor has other contracts requiring an approved EVMS, the auditor should also determine if deficiencies being reported in EVMS surveillance reports (11-203) have an impact on the contract under audit.

b. The auditor is responsible for advising the team chief, on the areas audited, whether the management system meets the requirements of the EVMS guidelines. Unresolved disagreements between the auditor and review team chief should be referred to the regional office and, when necessary, to DCAA Headquarters, ATTN: P.

c. If the auditor becomes aware of significant accounting or financial aspects of the contractor's EVMS that have been omitted from the IBR, initial compliance audit, or post acceptance audit for cause, thereby resulting in an inadequate review of the system, the circumstances should be immediately brought to the attention of the team chief and documented in the DCAA files. Comments on these matters should also be included in the audit report together with statements regarding their expected impact on the system and related reporting of contract performance.

d. An EVMS is intended for contractor use in managing contracts and for Government use in monitoring contract performance. Application of the provisions of DoDI 5000.2 should not result in the development or use of two systems, one for the contractor's internal use and the second merely to satisfy the intent of the guidelines. Evidence of intended or actual parallel operation should be fully evaluated and the results discussed with other members of the EVMS guidelines review team. A determination that only one system will be used is necessary prior to acceptance of the proposed EVMS.

e. Unrestricted access to all data affecting contract costs, both direct and indirect, including budgets and operating forecasts, is necessary to properly audit an EVMS. If the contractor refuses access to required data, the auditor will advise the team chief and the CMO EVMS monitor and enlist their aid in obtaining the information. If the contractor continues to deny access, the auditor will recommend, in writing, that the system not be accepted. In the event that access to required data is made available during the audit, but the auditor has been formally advised by an authorized representative of the contractor that the data will be withheld during the surveillance process, a comment to that effect will be included in the audit report, together with a statement that lack of access to data may result in qualification of system surveillance audit reports.

f. In addition to serving as EVMS guidelines review team members, auditors are responsible for monitoring contractor corrective action in assigned areas. If the contractor fails to take effective corrective

action or fails to make acceptable progress in resolving deficiencies, contractual remedies should be recommended (e.g., withhold progress payments, disallow costs).

g. In those cases when management control acceptance is delayed for an extended period of time after contract award because the system has not been fully accepted or has been found to be unacceptable, DCAA surveillance activities should concentrate on verification of reported data and consistency between cost and schedule information and information from other contractor systems.

11-202.7 Audit Procedures

a. Select those tests and other auditing procedures that are necessary to adequately complete the work assigned. These procedures will include tests to verify that the management control system meets the guidelines for the areas assigned. Make maximum use of prior audits and knowledge accumulated by prior audit staff so as to avoid duplication of effort. However, auditors should conduct sufficient tests of the assigned guidelines during each EVMS guidelines review to confirm that the management control system has in fact been implemented on the contract being audited.

b. In evaluating whether a contractor's management control system complies with the guidelines, the auditor should conduct audit procedures similar to those performed during surveillance of the EVMS guidelines (11-203.3). Guidelines which DCAA is commonly asked to evaluate include: Organization Guideline 4; Planning, Scheduling and Budgeting Guidelines 8, 9, and 13; all of the Accounting Considerations Guidelines; Analysis and Management Reports Guidelines 22, 24 and 27; and Revisions and Data Maintenance Guideline 30. See Part I, Section 2 of the EVMIG for a narrative description of each EVMS guideline. The team members should use the EVMS Evaluation Guide, Appendix B of the EVMIG (DCAAP 7641.47), as necessary in the examination of contractor management control systems to ensure compliance with the guidelines. The EVMS Evaluation Guide includes a restatement of guidelines, followed by the related system characteristics expected to

be part of an acceptable EVMS. Auditors will need to perform specific audit steps to verify that the expected system characteristics are present in the contractor's EVMS.

c. The auditor's supervisor will provide technical direction to assure the proficiency of the work performed. All work will be reviewed by the supervisor prior to forwarding reports or conclusions to the team chief.

11-202.8 Reporting Results of Audit

a. When the audit work related to an IBR, initial compliance audit, or a post acceptance audit for cause is finished, the auditor will discuss the findings and recommendations with the audit supervisor and furnish them to the team chief in such form and detail as required for the EVMS guidelines review team report, using the general guidelines provided in 10-1200. Any findings and recommendations will be provided to the team chief prior to completion of the in-plant effort of the EVMS guidelines review team to enable the team chief to conduct the exit conference with the contractor. The FAO will retain the detailed working papers covering DCAA's part of the audit. Working papers supporting the auditor's conclusions regarding compliance or noncompliance with specific guidelines will be documented in all instances and will include a record of the conclusions which have been furnished to the team chief. Reported deficiencies should be identified to specific guidelines or the contractor's system description whenever possible. The auditor's report will be formally issued as soon as possible after the EVMS guidelines review team exit conference with the contractor. The team chief will also be provided with any summary schedules and/or copies of working papers required for consolidation of statistical data or as additional supporting documentation for the EVMS guidelines audit file.

b. Provide Headquarters, ATTN: P, with a copy of each report which meets any of the following criteria:

(1) Recommends the disapproval of a previously accepted EVMS.

(2) Discloses significant discrepancies in a contractor's EVMS.

(3) Discloses significant restrictions on the audit caused by a denial of access to records.

11-203 EVM Surveillance Audits

a. Immediately following demonstration and acceptance of the contractor's management control system, surveillance by DCAA and the Contract Management Office (CMO) is performed to ensure that the contractor's system continues to comply with the EVMS guidelines and produces valid and timely data. Surveillance is also performed to ensure that any proposed or actual changes to the EVMS comply with the guidelines and are reflected in the contractor's system description. Surveillance includes verifying, tracing, and evaluating the information contained in the reports submitted to DoD procuring components. In the event deficiencies are disclosed, or if there is an indication of an adverse effect on contract performance because of such deficiencies, discuss the deficiencies with the contractor and notify the CMO EVMS monitor.

b. Basic auditor responsibilities during surveillance audits are summarized in Part II, Section 3-2a(3) of the EVMIG; more specific audit guidance is provided in the following paragraphs. The auditor's surveillance responsibilities, as identified in the EVMIG, include:

(1) reviewing the contractor's accounting system policies and procedures for compliance with EVMS guidelines and contract provisions (system surveillance) and

(2) performing periodic reviews of selective financial data contained in various reports submitted by the contractor to determine whether they accurately reflect the contractor's books and records (report surveillance).

c. A written description of the acceptable EVMS should be furnished to the auditor by the CMO EVMS monitor. The EVMS description should be included in the permanent files and used for planning the surveillance audit program.

d. To ensure adequate evaluation of the system and related output, and to preclude any duplication of effort, the FAO's programmed surveillance audits should be

coordinated with the CMO EVMS monitor. This coordination should include a discussion of those aspects of the system scheduled for audit, as contained in the FAO's annual plan. The program monitor should also be advised of other evaluations scheduled that may relate directly or indirectly to the EVMS. Formal agreement for surveillance activity should not be undertaken since the degree of surveillance required may vary considerably between contracts and from one period of contract performance to another.

e. As a minimum, the procedures contained herein will be considered in developing an audit plan for an EVM surveillance audit. The audit should include the procedures necessary to address any additional areas requested by the ACO or CMO EVMS monitor.

f. It is the prime contractor's responsibility to accept and maintain surveillance of subcontractor EVMSs. However, there are unique situations when a subcontractor EVMS will be accepted and/or surveillance will be performed by a DoD component rather than a prime contractor. This may occur when:

(1) the subcontractor, for competitive reasons, refuses access to records to a prime contractor;

(2) the subcontractor is performing multiple contracts containing EVMS reporting requirements under more than one prime contractor; or

(3) the subcontractor may be functioning as a prime contractor on an accepted EVMS.

g. In the instances described in f. above, the cognizant auditor at the subcontractor location will perform the necessary system surveillance by following the procedures described herein. When the prime contractor has retained surveillance responsibility, the audit plan at the prime contractor location should include the following steps:

(1) The prime contractor's program for surveillance of the subcontractor's EVM system should be evaluated to determine depth, scope, and overall adequacy.

(2) The results of the prime contractor's surveillance efforts, including follow up, should be evaluated to ensure that deficiencies are subsequently corrected.

(3) The results of the prime contractor's evaluation of subcontractor-reported data, including action taken by the prime on significant variances reported by the subcontractor, should be evaluated. The auditor should verify that estimates to complete the subcontract are revised to reflect the impact of significant variances.

(4) The timeliness of subcontract reporting and subsequent incorporation of related data in the prime contractor's monthly report should be evaluated.

(5) The auditor should report the need for necessary assist audits on areas not adequately evaluated by the prime contractor and on deficiencies disclosed by the prime contractor's surveillance activities that have gone uncorrected over an extended period of time. In this connection, auditors at subcontractor locations should advise auditors at prime contractor locations of any deficiencies noted during the system audit that may have an impact on the continued acceptability and validity of the subcontractor's system and related output. Routing of requests for assist audits and submission of audit reports will be accomplished through ACO channels.

11-203.1 Audit Objectives

a. System Surveillance. The objectives of the system surveillance portion of the audit are to ensure that the contractor's management control system continues to:

- (1) provide valid and timely management information;
- (2) comply with the DoD EVMS guidelines;
- (3) provide timely indications of actual or potential problems; and
- (4) provide baseline integrity.

b. Report Surveillance.

(1) The objectives of the report surveillance portion of the audit are to ensure that the contractor's required external cost management reports (CPR, C/SSR and CFSR) contain:

- (a) information that is derived from the same data base as that used by contractor management;
- (b) explicit and comprehensive variance analysis, including proposed corrective action in regard to cost, schedule, technical, and other problem areas; and

(c) information that depicts actual conditions.

(2) The cost management reports typically generated by a contractor's EVMS include:

(a) Cost Performance Report (CPR)

The objective of the CPR (DD Form 2734) is to provide data to Government system managers that may be used by them to:

- (i) evaluate contract performance,
- (ii) identify actual and potential problem areas having significant cost impact, and
- (iii) respond to requests for program status information on major weapon/support system acquisitions.

To permit this type of management control, the CPR requires, among other things,

- information on cost and schedule performance by work breakdown structure and functional cost categories,
- actual manpower utilization versus the budgeted plan, and
- narrative comments explaining major cost and schedule variances, as well as an identification of significant problems and action contemplated for their resolution.

The CPR is submitted monthly unless otherwise provided for in the contract.

(b) Cost/Schedule Status Report (C/SSR)

The objective of the C/SSR (DD Form 2735) is to provide summarized cost and schedule performance status information on contracts over 12 months in duration when application of the Cost Performance Report (CPR) is not appropriate. The C/SSR requires:

- (i) information on cost schedule performance by work breakdown structure and
- (ii) narrative comments explaining major cost and schedule variances, as well as an identification of significant problems and action contemplated for their resolution.

The C/SSR is submitted in accordance with the terms specified in the contract, but is not required more frequently than monthly.

(c) Contract Funds Status Report (CFSR)

The objective of the CFSR (DD Form 1586) is to provide information about contract funding requirements for specifically

designated programs to assist the system manager in:

- (i) updating and forecasting contract fund requirements,
- (ii) planning and decision making on changes in the fund requirements,
- (iii) developing fund requirements and budget estimates in support of approved programs, and

- (iv) determining funds in excess of contract needs and available for deobligation.

The CFSR is normally prepared quarterly and submitted within 25 calendar days after the cut-off date or the number of days specified in the contract. Under unusual circumstances monthly reporting may be required.

11-203.2 Scope of Audit - General

a. EVM surveillance audits should be performed at least once a year, but should be performed as frequently as necessary to ensure continued reliance on the system and related output. Based on a risk assessment, the scope of the surveillance audit may:

- (1) include system and report surveillance or

- (2) be limited to report surveillance.

b. An initial determination of the overall scope of the surveillance audit (i.e., system and report surveillance or report surveillance only) will be made based on a risk assessment performed as part of the annual program planning process. Report surveillance will be performed on at least an annual basis. The need for system surveillance will be based on the following criteria:

- (1) A detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines should be performed every two to four years.

- (2) If a detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines has been performed within the last two to four years, a limited system evaluation should be planned to cover the portions of the system affected by the following specific risk factors, to the extent that they exist:

- (a) changes in the system since the last detailed evaluation was performed,

- (b) related internal control deficiencies, and

- (c) any specific ACO concerns.

- (3) If a detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines has been performed within the last two to four years, and none of the risk factors identified above exist, no system surveillance is required for the current FY. Only report surveillance would be required.

11-203.3 Scope of Audit – System Surveillance

a. System surveillance may consist of either a detailed evaluation, encompassing all of the EVM guidelines assigned to DCAA, or may be limited to the guidelines related to the specific risk factor identified.

b. In evaluating the compliance with the EVM guidelines, the auditor should consider the system characteristics related to the guidelines, as contained in the EVMS Evaluation Guide.

c. The auditor should consider the testing performed in related internal control audits (e.g., planning and budgeting, MMAS) when determining the testing required in the system surveillance audit. The testing performed in the related internal control audits should be used, to the extent possible, in determining the contractor's continued compliance with the EVM guidelines under review.

d. If the contractor's system has changed since the last surveillance audit, the auditor should evaluate the changed policies and procedures for continued compliance with the EVM guidelines under review.

e. For all system surveillance audits, the auditor should select a sample of contracts to test to ensure the contractor has followed through with the implementation of the guidelines on contracts.

11-203.4 Scope of Audit – Report Surveillance

a. A universe of contracts with cost management reporting requirements (e.g., CPR, C/SSR, or CFSR) should be developed during the annual program planning

process. Auditors may develop the universe of contracts based on:

- (1) data obtained from the contractor,
- (2) data obtained from the ACO,
- (3) briefing contract provisions, specifically the Contract Data Requirements List (CDRL), DD Form 1423, or
- (4) a combination of the data sources.

The universe of contracts should include contracts containing EVM requirements (DFARS 252.234-7001) as well as contracts which, while they do not contain the EVM requirement, include requirements for submission of the CPR, C/SSR, or CFSR.

b. The auditor should coordinate with the ACO to identify any sensitive, high risk, or high visibility contracts.

c. The auditor should select a sample of contracts to be tested as part of the annual EVM report surveillance. The sample of contracts should reflect:

(1) high-risk or sensitive contracts, including contracts where problems were identified in prior year testing, plus

(2) a three-year cycling of all other contracts containing reporting requirements, with at least one contract tested per year. The auditor should determine the extent of testing of report data and select the specific reports to be tested under the selected contracts based on the results of the audit risk assessment.

d. The auditor should audit the selected reports using the procedures below.

(1) Evaluation of Cost Management Reports (CPR, C/SSR, CFSR)

The purpose of evaluating the selected cost management reports is to ensure that the reports:

- (a) are mathematically accurate;
- (b) comply with contractual requirements, such as reporting due dates, format; and content; and
- (c) are supported by the contractor's books and records.

The Performance Measurement Baseline is the time-phased budget plan against which contract performance is measured. It is formed by the budgets assigned to scheduled cost accounts and the applicable indirect budgets, which may also be known as the scheduled direct costs and applicable expense rates, and is sufficiently detailed to the work package level to ensure adequate

performance measurement. The Budgeted Cost for Work Scheduled (BCWS) is the sum of budgets for all work packages scheduled to be accomplished and is the measurement of work scheduled to be accomplished within a given time period. The Budgeted Cost for Work Performed (BCWP) is the sum of budgets for completed work accomplished. The Actual Cost of Work Performed (ACWP) is the cost incurred and recorded in accomplishing the work performed within a given time period. Each of these terms is precisely defined in Appendix D of the EVMIG (See DCAAP 7641.47). The auditor should consider the following procedures in evaluating the selected reports:

(i) From the lowest levels, work packages, or cost accounts, the auditor should summarize the budgeted and actual costs (accrued expenditures for the CFSR) through the Work Breakdown Structure (WBS) to the contract level and the CPR, C/SSR, or CFSR. This should be done for both the current month and cumulative to date amounts.

(ii) The auditor should verify that the BCWS and the BCWP on the CPR or C/SSR were computed in accordance with the Performance Measurement Baseline for the contract.

(iii) Amounts should be summations from the lowest points of accumulation without intermediate allocations.

(iv) Indirect cost and labor rates applied should be the originally planned rates for work scheduled (BCWS) and work accomplished (BCWP). Also, verify that acceptable rates are used for actual costs (e.g., the rates are calculated and applied in accordance with the contractor's usual/disclosed cost accounting practices).

(v) The auditor should obtain and review the contractor's reconciliation of the selected reports to its job cost ledgers. Selectively trace the reported actual cost data to the contractor's job cost ledgers.

(vi) Deficiencies disclosed or errors noted should be discussed with contractor personnel for subsequent correction. Schedule subsequent surveillance audits to verify that required follow-up actions have been completed.

(2) Reconciliations of Cost Management Reports (CPR, C/SSR, CFSR)

The purpose of reconciling external cost management reports, such as the CPR, C/SSR, and CFSR with each other and with contractor internal reports and other external reports, such as the Contractor Cost Data Report (CCDR), Quarterly Limitation on Payments (QLOP), progress payment requests, and public vouchers, is to ensure that the information being reported is accurate and differences in data from one report or level to another are logical, consistent, and explainable. The contractor should make the necessary reconciliations. The auditor should perform the following validation steps:

(a) The auditor should verify reconciliations between the CPR or C/SSR and the CFSR for contract target, actual cost, and estimated final cost.

(b) When applicable, the auditor should verify reconciliations of internally-reported and CPR or C/SSR-reported data with CCDR-reported data or other external data for actual costs to date and estimated final cost.

(c) In those instances when the reports do not reconcile or the reasons for variances do not appear valid, the auditor should coordinate with the ACO and the CMO EVMS program monitor in recommending necessary changes to ensure that subsequent valid reconciliations can be made.

(3) Evaluation of Estimate at Completion Reported on Cost Management Reports (CPR, C/SSR, and CFSR)

(a) The frequency of evaluations of the latest revised estimates at completion (EAC) for a contract will depend upon the adequacy of the contractor's procedures, including internal audit procedures and the extent of contract changes which may, to some extent, give rise to revisions to the anticipated cost at completion. Because of the importance of estimated costs at completion, to both the contractor and the Government, the auditor should perform a critical evaluation of the contractor's proposed amount. Coordination with technical personnel is necessary to properly evaluate the estimate at completion and preclude duplication of effort.

(b) Contractors sometime report EACs to the Government for billing and EVMS guidelines purposes that are different than

those used for financial reporting purposes because of different risk assumptions and profit expectations. This is not a problem if the contractor can reconcile the differences. While it is necessary for auditors to compare EACs used by contractors for financial reporting purposes with those reported to the Government, the provisions of DoDI 5000.2 and the EVMS guidelines do not require a contractor to make such reconciliations, and should not be used to gain access to financial statements. However, auditors should evaluate multiple EACs disclosed during EVMS guidelines audits. The contractor's inability to provide reconciliations may indicate performance to date and estimates of future conditions are not being accurately reflected in the contractor's EAC process, which could be an EVMS deficiency. Auditors should typically pursue access to EACs used for financial reporting purposes in these instances under billing system/progress payment audits.

(4) Variance Analyses (CPR, C/SSR)

(a) The CPR and C/SSR provide for monthly disclosure of schedule and cost variances and contractor comments on significant problem areas, reasons for variances, their impact on the program, and corrective action taken or to be taken. The purpose of the variance analysis is to assess variances in terms of their contribution to cost growth and schedule slippage. The auditor's responsibilities with respect to evaluating variances are to ensure that timely and responsible actions are taken by the contractor to:

(i) identify their causes and

(ii) minimize the impact of the variances on contract performance.

(b) Since schedule slippage and problems in technical performance contribute to variances, the evaluation of variances and the contractor's proposed actions with respect thereto should be coordinated with the Government program monitor and/or technical personnel. The following steps should be followed in evaluating variances:

(i) On a sampling basis, the auditor should select areas of significant cost variances, including those caused by indirect rate variances, as identified in the CPR or C/SSR, and trace to the required action level. The CPR or C/SSR generally pro-

vides for reporting of indirect expenses as a line item. The contractor will analyze significant variances between the planned and actual rates and, when unfavorable variances exist, the contractor should indicate the cause and corrective action to minimize the effect on cost performance. The auditor should be aware of rates used to establish the performance measurement baseline as related to the rates being reported, and also of any anticipated changes expected to occur that affect the value of planned effort, such as volume fluctuation, terminations, and revisions to the rate structure. Surveillance reports should indicate the actions taken by the contractor with respect to unfavorable variances and also data on expected changes that may create significant variances in subsequent periods.

(ii) The auditor should determine if the narrative descriptions of the variances are valid and adequate.

(iii) Causes and proposed remedies of the variances should be discussed with the contractor to determine if proposed actions will be responsive to the nature of the problem.

(iv) The auditor should evaluate estimated cost at contract completion to determine if the impact of any existing variances are reflected in the estimate to complete the contract.

(v) As necessary, the auditor should follow-up to ensure the contractor has effectively implemented its proposed corrective action(s) on the significant variances.

11-203.5 Reporting Results of Audit

a. As discussed in 11-203.2a, the scope of the EVM surveillance audits may include system and report surveillance or be limited to report surveillance.

The surveillance audit report should be prepared in accordance with 10-1200 and provide clear statements of the scope of the audit (i.e., system and report surveillance or report surveillance only) and any deficiencies noted, together with recommendations for their correction. Comments should also be provided regarding the results of discussions with the contractor's representative on deficiencies disclosed. To ensure that all pertinent data have been consid-

ered, the audit findings and recommendations will be discussed with the CMO EVMS monitor prior to issuance of the report. Systemic EVMS deficiencies should be highlighted in the report. Whenever possible, the auditor should relate any deficiencies to specific EVMS guidelines. The report should be issued in a timely manner to ensure report recommendations may be acted on appropriately. The report should be addressed to the principal cognizant ACO. A copy of the report will be provided directly to the CMO EVMS monitor, the affected program office(s), and the FLA(s) where applicable. A copy of each report meeting any of the criteria stated in 11-202.8.b above will also be provided Headquarters, ATTN: P.

b. When applicable, surveillance reports should include a reference to reports issued on the results of system audits (see 10-408.2f) that had an impact on or were affected by the EVMS.

c. Deficiencies being reported in surveillance reports should also be reported in audit reports in an appendix on Other Matters on proposals expected to result in contracts covered by DFARS clause 252.234-7001, Earned Value Management Systems, or DFARS clause 252.242-7005, Cost/Schedule Status Report.

d. When deficiencies are disclosed while performing audits of material management and accounting systems (MMAS), labor, other accounting systems, forward pricing rates, budgets, and billing systems, the auditor will assess whether the deficiencies are likely to have a material effect on the reliability of the contractor's EVMS and provide comments in the related report on the system or forward pricing rates. The auditor should immediately evaluate the impact of these deficiencies on the contractor's EVMS data for specific contracts and, where material, provide the details in a flash EVMS surveillance report (10-1200). When a flash report is issued, periodic EVMS surveillance audits are still required.

e. When an audit of a CFSR submission discloses that a loss is anticipated for a fixed-price contract, the auditor will ascertain whether the contractor is entitled to progress payments. If so, the auditor should make sure that the indicated rate of loss

disclosed in the CFSR audit is appropriately applied by the contractor for purposes of computing its progress payment request.

f. Continued availability of information supporting earned values, incurred costs, and estimates to complete is necessary to perform proper surveillance of EVMS. In the event access to required contractor data is withheld or unduly restricted, follow the procedures in 11-500. When denial is continued, each surveillance report should include appropriate modification of the scope and opinion statements, with identification of the data being denied and its relationship to system surveillance requirements. If internal management budgets and forecast data are not made available during the surveillance audit, the auditor should qualify the audit report and recommend that the system validation be with-

drawn. When applicable, the CAC should establish uniformity in necessary report qualifications to ensure consistency within corporate structures when more than one corporate segment is subject to EVMS requirements.

11-204 Requested Audits of Individual CPR, C/SSR, and CFSR Reports

Periodically, contracting officers may request audits of individual cost reports submitted by EVM-covered contractors. Auditors should use the procedures set forth in 11-203.4d, modified as appropriate, to evaluate the individual report submissions. Reports on individual CPR, C/SSR, or CFSR submissions should be prepared in accordance with 11-203.5.

11-300 Section 3 --- Audit of Selected Cost Management Reports Submitted by Contractors Without Earned Value Management (EVM) Reporting Requirements

11-301 Introduction

This section provides audit procedures and guidance for auditing contractor management control systems, and the related cost reports (Cost Performance Reports (CPRs), Cost/Schedule Status Reports (C/SSRs), and Contract Fund Status Reports (CFSRs)) at contractors who do not have contracts containing earned value management (EVM) reporting requirements. Audit guidance for contractors with EVM reporting requirements is contained in 11-200.

11-302 Background

a. Over many years, the Office of the Secretary of Defense and the military departments have developed a variety of management systems for use in the acquisition process. These systems provide the Government with the ability to obtain timely and valid cost, funding, schedule, and related management information for use in contract performance analysis and program control. In March 1996, DoD Directive 5000.1, and DoD 5000.2-R, "Mandatory Procedures for Major Defense Acquisition Programs (MDAPs) and Major Automated Information System (MAIS) Acquisition Programs," respectively, were issued replacing all previous DoD acquisition management policies and procedures. DoD contract cost management reporting requirements such as the CPRs, C/SSRs, and CFSRs were contained in DoD 5000.2-R, Subpart 7.15.7, "Contract Management Reports" until October 30, 2002. On October 30, 2002, DoD Directive 5000.1 and DoDI 5000.2 were canceled and replaced with interim guidance. DoD 5000.2-R was converted from regulation to non-mandatory guidance and is now referred to as the Interim Defense Acquisition Guidebook. In May 2003, DoD Directive 5000.1 and DoDI 5000.2 were reissued. Under the reissued DoD Directive 5000.1 and DoDI 5000.2, cost management reporting using the CPR, C/SSR, and CFSR is no longer mandatory, but rather at the discretion of the contracting officials. DCAA audit ef-

fort related to the CPR, C/SSR, and CFSR at contractors who do not have contracts containing EVM reporting requirements primarily involves the evaluation of contractor financial records to validate the accuracy and propriety of reported data.

b. The audit of a contract and the briefing of its provisions (see 3-200) will disclose whether the contract incorporates CPR, C/SSR, or CFSR reporting requirements.

(1) Cost Performance Report (CPR)

The objective of the CPR (DD Form 2734) is discussed in 11-203.1b(2)(a).

(2) Cost/Schedule Status Report (C/SSR)

The objective of the C/SSR (DD Form 2735) is discussed in 11-203.1b(2)(b).

(3) Contract Funds Status Report (CFSR)

The objective of the CFSR (DD Form 1586) is discussed in 11-203.1b(2)(c).

11-303 Audit Requirements

a. An annual risk assessment will be performed during the annual program planning process for each contractor without EVM-covered contracts, but with contracts containing CPR, CSSR, and/or CFSR reporting requirements. The risk assessment considers:

(1) the number of contracts containing CPR, C/SSR, or CFSR reporting requirements,

(2) sensitive or high risk contracts or conditions identified by the ACO, and

(3) the expected volume of covered contract reports where an audit will be requested.

The risk assessment is used to determine whether to perform a self-initiated audit of the contractor's policies and procedures for accumulation of data and preparation of CPRs, CSSRs, and/or CFSRs, as well as selectively testing financial data contained in them.

b. Audits of individual CPR, C/SSR, or CFSR reports may be requested by the contracting officer. The contracting officer may also request an audit prior to the award of a contract under which CPR,

C/SSR, or CFSR requirements are contemplated to determine if the contractor's management system and procedures are adequate and reliable for CPR, C/SSR, or CFSR purposes, and will also consider the contractor's procedures for accumulating and reporting actual costs (cumulative expenditures for CFSR) and for estimating contract completion costs.

11-304 Audit Objectives and Procedures

a. Where an audit of the contractor's management system and procedures relative to CPRs, C/SSRs, and CFSRs is required, either based on a specific request from the contracting officer or based on the risk assessment described in 11-303a, evaluate the contractor's policies and procedures for developing and reporting actual and projected costs in the CPRs, C/SSRs, and CFSRs to ensure the system will produce accurate data that complies with contractual reporting requirements.

b. Use the procedures at 11-203.4d to perform audits of individual CPR, C/SSR, or CFSR reports requested by the contracting officer. Also use the procedures at 11-203.4d to selectively test financial data contained in the CPRs, C/SSRs, and/or CFSRs submitted by the contractor, based on the risk assessment described in 11-303a.

11-305 Reporting Results of Audit

a. An audit report will be prepared:

(1) on each audit of contractor management system and procedures requested by the contracting officer,

(2) in response to the request of the contracting officer for audits of individual CPRs, C/SSRs, or CFSRs, and

(3) on each self-initiated audit of the contractor's policies and procedures for accumulation of data and preparation of CPRs, C/SSRs, and/or CFSRs.

b. Audit reports will be prepared in accordance with 10-1200 and provide clear statements of the scope of the audit and any deficiencies noted, together with recommendations for their correction. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the ACO prior to issuance of the report.

c. Audit reports will be addressed to the activity requesting the audit with a copy to the ACO. Reports resulting from audits initiated by the auditor will be addressed to the ACO. A copy of the report will be provided to the affected program office(s), and the FLA(s), where applicable.

d. When an audit of a CFSR submission discloses that a loss is anticipated for a fixed-price contract, the auditor will ascertain whether the contractor is entitled to progress payments. If so, the auditor should make sure that the indicated rate of loss disclosed in the CFSR audit is appropriately applied by the contractor for purposes of computing its progress payment request.

11-400 Section 4 --- Audits of Contractor Cost Data Reports (CCDRs)**11-401 Introduction**

The purpose of the CCDR system is to serve as the primary cost database for most DoD cost estimating efforts. DoD Components use the data collected in the CCDR system to:

(1) prepare program cost estimates for major system acquisition programs reviewed by the Defense Acquisition Board (DAB) and the Component Acquisition Executive (CAE);

(2) develop independent Government cost estimates in support of cost and price analyses and to estimate future contract costs; and

(3) develop estimates to support Analysis of Alternatives (AoAs), Cost as an Independent Variable (CAIV), and long-range planning efforts.

Detailed guidance related to CCDRs is contained in DoD 5000.4-M-1, the Contractor Cost Data Reporting (CCDR) Manual.

11-402 Acquisition Program Categories

DoDI 5000.2 specifies CCDR requirements based on a contract's designated acquisition program category. Category I applies to:

(1) all major defense acquisition programs that are estimated by the Under Secretary of Defense (Acquisition, Technology, and Logistics) to require an eventual total research, development, test, and evaluation (RDT&E) expenditure of more than \$365 million, or an eventual total procurement expenditure of more than \$2.190 billion in constant fiscal year 2000 dollars and

(2) other programs designated as Category I due to special interest.

Category IA applies to:

(a) all major automated information systems that are estimated by the DoD Component Head to require program costs (all appropriations) in any single year in excess of \$32 million, total program costs in excess of \$126 million, or total life-cycle costs in excess of \$378 million in constant fiscal year 2000 dollars, and

(b) other programs designated as Category IA due to special interest. Category II

applies to (1) all major systems not meeting the criteria for Category I, but estimated by the DoD Component Head to require an eventual total expenditure for RDT&E of more than \$140 million, or an eventual total procurement expenditure of more than \$660 million in constant fiscal year 2000 dollars, and (2) other programs designated as Category II due to special interest. Category III applies to programs not meeting the criteria for Category I, IA, or II.

11-403 Category I/IA Reporting Requirements

Unless waived by the Chair, OSD Cost Analysis Improvement Group (CAIG), for Category I acquisition programs, CCDRs are required for all major contracts and subcontracts valued at more than \$50 million in constant fiscal year 2002 dollars, regardless of contract type. CCDR reporting is not required for contracts priced below \$7 million in constant fiscal year 2002 dollars. The CCDR requirement on high-risk or high-technical-interest contracts priced between \$7 and \$50 million in constant fiscal year 2002 dollars is left to the discretion of the Cost Working Integrated Product Team (IPT). CCDR reporting does not apply to Category IA acquisition programs.

11-404 Category II and III Reporting Requirements

Contracts under Categories II and III acquisition programs, meeting the Category I contract dollar thresholds for CCDR reporting, also require CCDR reporting. However, specific program reporting requirements are left to the discretion of the military services. The level of detail and frequency of reporting for Category II and III programs is normally less stringent than the level of detail and frequency required for Category I programs.

11-405 CCDR Implementing Procedures

To implement CCDR, the procuring activity must prepare a program CCDR plan showing the proposed collection of cost data

by work breakdown structure for each program being reported, the required CCDR form, and the frequency with which reports are required. This plan must be approved by the CAIG Chair. The approved CCDR requirements are included in the Request for Proposal (RFP). In response to the RFP, the contractors submit a draft contract CCDR plan for negotiation with the DoD program office. The agreed-to-plan is submitted to the Defense Cost and Resource Center (DCARC) for coordination of the approval by the CAIG Chair prior to contract award. The approved CCDR plan is included in the contract and the required CCDR forms are incorporated in the contract by inclusion in the Contract Data Requirements List (CDRL).

11-406 CCDR Forms

a. CCDR forms from the 1921 series are the basis for the contractor's response to the Request for Proposal (RFP). Contractors will submit the information in the format required in the solicitation (for example, FAR 15.408, Table 15-2), supported by the CCDR forms when required by the procuring activity.

b. Discussed below are three DD forms for CCDR. A fourth form, the Plant-Wide Data Report (DD 1921-3) was deleted as a CCDR requirement as of December 31, 1999. The DD 1921-3 was replaced with forward pricing rate data now submitted to the DCARC by DCMA.

(1) The Cost Data Summary Report (DD Form 1921) summarizes all contract activities and reports total costs against each of the work breakdown structure reporting elements specified in the contract. The contractor submits this report as a program estimate in response to a request for proposal at the time of contract award, and as the contract specifies. It provides summary level cost data, cumulatively to date and estimated at completion, with a breakout of recurring and nonrecurring costs.

(2) The Functional Cost-Hour Report (DD Form 1921-1) identifies comparable functional cost and labor-hour data; for example, engineering, tooling, and manufacturing for the contract and/or selected reporting elements in the contract. A

breakout is required for recurring and non-recurring costs. These reports are also submitted as a program estimate in response to a request for proposal, and as the contract specifies.*

(3) The Progress Curve Report (DD Form 1921-2) provides a unit or an average unit cost of the unit or lot accepted during the reporting period. It also gives functional labor-hour and cost data on the average cost of units or lots accepted, the estimate for the next unit or lot, and the estimate to complete the contract. The report includes only recurring cost. The contractor must submit the report as specified in the contract. Contracts which do not provide for deliverable end items or hardware do not require this report, nor do requests for proposals.

11-407 Objectives of the Audit

The auditor is required to evaluate the effectiveness of the contractor's policies, procedures, and practices to produce data compatible with the objectives of CCDR and make selective tests of reported data.

11-408 Audit Procedures

a. If the contractor's CCDR system has not been audited, the DCARC may request the auditor to evaluate the contractor's proposed procedures for accumulating data and CCDR preparation to assure their compatibility with the accounting system and the reporting requirement in the RFP. Methods for auditing data in support of a price proposal should not be changed because of CCDR formats; however, the auditor should point out problems caused by system deficiencies to the contracting officer. Identifying and correcting deficiencies is critical at this point because the data, in the prescribed format, becomes the baseline for negotiation as 10 U.S.C. 2306a (TINA), and 41 U.S.C. 422 (CAS) purposes. Forms submitted at the time of contract award become the baseline for DoD data bank purposes and measuring contract performance. Failure to identify and correct major deficiencies would negate the purpose of the CCDR by making comparison of data meaningless.

b. The DCARC may request an audit of the first CCDD submission that includes actual costs under a contract. If the contractor's CCDD system policies and procedures have not previously been audited, or if requested by the DCARC, the audit scope should include an evaluation of the effectiveness of the contractor's policies and procedures for accumulating data and preparing CCDDs. The DCARC may request other audits of individual CCDD submissions as necessary.

c. Evaluate the effectiveness of the contractor's system, policies, and procedures for accumulating data and preparing CCDDs at least once each year. In this evaluation, select a sample of the contractor's CCDD-covered contracts for testing of report data to assure that the reported data are accurate and conform to the requirements of DoD 5000.4-M-1. Coordinate with the DCARC to identify any high risk or sensitive contracts to include in the sample. Audits will be performed more frequently if they disclose significant deficiencies.

d. As with most audits, auditors should consider the results of other evaluations, such as internal control audits, in determining the scope of audit. This will minimize work required to accomplish the objectives of the CCDD audit.

e. The auditor should verify the contractor's reported incurred to date costs, hours, and unit or lot cost to the contractor's accounting system and other supporting documentation where applicable. Request technical assistance, as necessary, to verify the contractor's classification of cost as recurring or nonrecurring, classification of costs by functional area, and estimates of unit or lot cost, where applicable.

f. Evaluate the contractor's reported estimate at completion. The evaluation should assure that it is the "best estimate" without regard to established ceilings or contract price, and that the contractor has properly considered currently authorized work plus any additional directed work for which execution or negotiation of amendments is pending. This also includes work not formally included in the contract price. Request technical assistance, as necessary, to evaluate the reported estimate at completion.

g. The auditor should evaluate the contractor's inclusion of subcontract costs, if applicable, for compliance with the requirements of DoD 5000.4-M-1. DoD 5000.4-M-1 provides specific guidance on the incorporation of subcontract data in each of the CCDD forms, depending on whether the subcontractor

(1) reports CCDD data to the prime contractor;

(2) reports CCDD data directly to the DCARC; or

(3) has no CCDD reporting requirement.

h. Compare CCDD data with similar contractor information in other financial management reports, such as Contract Funds Status Reports and Cost Performance Reports, if applicable, for agreement or reconcilability.

i. The CCDD audit will include evaluating contractor compliance with report due dates in the contracts or established between the contractor and the contracting officer. Discuss deficiencies in meeting due dates with the contracting officer so that corrective action can be taken.

11-409 Reporting Results of Audit

a. An audit report will be prepared using the format contained in 10-1200, covering the contractor's first CCDD submission that includes actual costs for each contract. The report will state the auditor's opinion on whether the contractor's CCDD preparation policies and procedures, if evaluated in the audit, are adequate and whether the CCDD evaluated is accurate and supported by the contractor's books and records.

b. If the audit discloses significant deficiencies, or the contractor cannot reconcile specific data with similar information for comparable periods, the audit report will:

(1) show the deficiencies' effect on the accuracy of the reported cost data,

(2) specify reports to which deficiencies pertain,

(3) recommend contractor corrective action, and

(4) state the contractor's reaction to the recommendations and any corrective action planned or initiated.

Audit reports will include the status of any previously reported deficiencies that have not been satisfactorily corrected. To ensure that all pertinent data have been considered, the auditor will discuss findings and recommendations with the contracting officer before the report is issued.

c. All audit reports will be issued to the Defense Cost and Resource Center (DCARC) through the administrative contracting officer, with a copy to the desig-

nated DoD component official responsible for CCDR and a copy to the FLA(s), where applicable. The DCARC's address follows:

Defense Cost and Resource Center
1111 Jefferson Davis Highway
West Tower, Suite 500
Arlington, VA 22202